VZCZCXRO8929
OO RUEHAST RUEHBI RUEHCI RUEHDBU RUEHLH RUEHNEH RUEHPW
DE RUEHNE #1030/01 1401241
ZNR UUUUU ZZH
O 201241Z MAY 09
FM AMEMBASSY NEW DELHI
TO RUEHC/SECSTATE WASHDC IMMEDIATE 6676
RHEHAAA/WHITE HOUSE WASHDC IMMEDIATE
RUEATRS/DEPT OF TREASURY WASHDC IMMEDIATE
RUCPDOC/DEPT OF COMMERCE WASHDC IMMEDIATE
RHEHNSC/NSC WASHDC
RUCNDT/USMISSION USUN NEW YORK 8055
RUEHGV/USMISSION GENEVA 8325
RUEKJCS/JOINT STAFF WASHDC
INFO RUCNCLS/ALL SOUTH AND CENTRAL ASIA COLLECTIVE
RUEHCI/AMCONSUL KOLKATA 3911
RUEHCG/AMCONSUL CHENNAI 4699
RUEHBI/AMCONSUL MUMBAI 3740

UNCLAS SECTION 01 OF 03 NEW DELHI 001030

STATE FOR SCA/INS JASHWORTH AND SCA/RA MURENA
USDOC FOR 4530/ITA/MAC/OSA/LDROKER/ASTERN
DEPT PASS TO USTR FOR SOUTH ASIA - CLILIENFELD/AADLER
DEPT PASS TO TREASURY FOR OFFICE OF SOUTH ASIA - MNUGENT
TREASURY PASS TO FRB SAN FRANCISCO/TERESA CURRAN

SENSITIVE
SIPDIS

E.O. 12958: N/A
TAGS: ECON EFIN EINV ETRD EAGR PREL PGOV PTER IN
SUBJECT: REFORM PROSPECTS IN NEW GOVERNMENT

NEW DELHI 00001030 001.2 OF 003

Reftel Mumbai 198

¶1. (SBU) Summary: More than 400 million Indians cast their vote in India's national parliamentary elections this past month and seem to have decisively signaled that they want stability and continuity in the national government, handing Congress an 18-year best performance of more than 200 seats out of 543 seats in India's lower house of Parliament, the Lok Sabha. With the Left parties reduced to a fraction of their prior strength and the Congress-led UPA's strength sufficient without Left support, expectations are soaring high for Prime Minister Manmohan Singh to move on economic reforms. Post expects passage of stalled legislation boosting foreign investment in insurance, liberalizing voting rights in the banking sector, and empowering the pension regulator, as well as partial divestment of government stakes in public companies. However, long-needed reforms in labor, education, energy, as well as FDI in retail, may remain elusive or slow in coming. India Inc tripped the upper circuit breakers of the Bombay Stock Exchange on May 16 but its euphoria should be tempered and expectations lowered. Congress still has allies to manage, as well as some areas of resistance from within its own party and special interests. The way forward will be much clearer in the next few weeks as the new government decides ministerial assignments and issues a 100-day plan, which Post will cover septel. End summary.

Unfettered Congress

¶2. (SBU) India Inc. and economists alike have noted their hopes in recent days that the Congress' big win and comfortable margin in Coalition numbers, without the Left's impediment, will lead to rapid and further progress in reforms. The markets reflected this when they opened on May 16 (reftel), responding with record one-day gains to Congress' best win in 18 years, Manmohan Singh becoming the first prime minister since Jawaharlal Nehru to be re-elected after serving a five-year term, and the Left allies reduced to a shadow that is not needed in the formation of a ruling coalition. All of these developments have raised very high expectations that Prime Minister Singh can now move unimpeded in implementing a full roster of needed, but long stalled, second generation reforms.

¶3. (SBU) Commentators have been quick to identify both unfinished legislative business as well as new reforms that the new government is expected to take up. Post expects quick progress on stalled legislation boosting foreign investment in insurance, liberalizing voting rights in the banking sector, and empowering the pension regulator, as well as partial divestment of government stakes in public companies. But overdue reforms in labor as well as more FDI into retail may take a back seat, as resistance and entrenched interests exist outside of the Left parties on these issues. Kamal Nath, former Commerce Minister, already claimed on May 16 that FDI in retail would not be liberalized in the short term.

Low Hanging Fruit - Stalled Legislation

¶4. (SBU) With the Left no longer able to stymie passage of key reform legislation, it is expected that already-introduced bills to raise FDI in insurance, provide proportionate voting rights to bank equity holders, and authorize the new pension regulator, the PFRDA, will receive quick passage this summer in the new Parliament. The insurance amendment bill, which proposes raising FDI in insurance from the current 26% cap to 49%, was blocked by the Left parties and some domestic firms. With the Left gone and all players now hurting for investment, it should face no resistance. The pension bill, named for the creation of the Pension Fund Regulatory and Development Authority (PFRDA), has been mostly enacted already by administrative fiat, and should easily pass. While the Parliament must sit by June 2, it is likely to adjourn until the new Budget is ready for introduction. Media are currently citing official projections of 45 days to finalize and present the new budget, so Post expects the Budget Session to kick off in earnest in early July and last until early August. The government is also expected to move quickly on permitting partial divestment in publicly-owned companies, which not only would inject more discipline and

efficiency into such companies, but help raise needed government revenues.

Other Reforms Being Floated

¶5. (SBU) Media is also reporting that Ministries have been tasked with forwarding new policies to the Cabinet, for formulation of a 100-day plan for the new government. Some proposals that have been floated before, but not picked up, are supposed to be seeing new life. These include a proposal to allow foreign airline carriers to invest in Indian civil aviation companies. Foreign carriers are currently banned, but the struggling aviation industry, hit by the economic downturn, could use the capital infusion. A 3G auction to license rights to use and sell "third generation" - 3G - mobile phone and IT technology could also finally see the light of day, as well as a long postponed spectrum policy. Licenses to coal mining which are heavily tilted towards state-owned companies could be expanded to more private players as well. The restriction on coal mining not only prevents foreign investment in the industry but also creates upstream input hurdles to prospective energy companies who need to ensure sufficient and affordable coal inputs. The government is reportedly also considering revising the highway tender and bid process, as more than four-fifths of projects that were offered in the last few years received no takers. All of these would help improve infrastructure, which the government still prioritizes but lacks sufficient funding to do without more private participation.

¶6. (SBU) Hopes for reform of subsidies are also riding high. Press reported that the Petroleum Ministry is supposedly drafting a policy to decontrol fuel pricing, which cost the government, through its oil marketing companies, roughly $25 billion last year when global oil prices spiked. There is an argument to be made that most of the fuel subsidies benefit the urban middle class. If many in Congress feel that their win is due to their focus on the rural sector, the high cost of this subsidy could be seen as usurping funds that could be spent on extending the rural employment guarantee program and needed rural infrastructure. Likewise, energy subsidies on kerosene and cooking gas could be restructured to better target lower income

users, perhaps through the use of smart cards. Such technology might also be introduced to streamline food subsidies, which cost the government about $12 billion last year (roughly three times the cost of the rural employment guarantee program), yet barely gets to poverty-line recipients.

Probably Not So Fast

¶7. (SBU) After the election results were announced on May 16, many press reports quickly pointed to improved chances for increased FDI in retail, which was vociferously resisted by the Left parties. Currently, only 51% FDI in single-brand retail and 100% FDI in wholesale is allowed, while no FDI is allowed in multi-brand retail. However, prospects for further opening the retail sector remain questionable, as more than just the Left parties are concerned that foreign organized retail will adversely impact the estimated 30-40 million mom-and-pop stores, known as kiranas. Reformers can point to a report undertaken by prestigious think tank ICRIER that indicated that kiranas would not necessarily be hurt by the growth of organized retail and could co-exist with it. However, the numerous and vocal critics of organized retail could still successfully pressure the government to move very slowly on this investment liberalization.

¶8. (SBU) Talk of reducing government holding in banks to below 50 percent, in order to facilitate consolidation in state-owned banks, which control roughly 70% of total banking assets, may also be premature. The central bank, the RBI, already signaled its hesitation to embark on significant banking liberalization in its April Monetary Policy Statement, putting on indefinite hold its scheduled 2009 consideration of a "banking roadmap". Contacts and commentators perceive that one of the fallouts of the global financial crisis is a new wariness of foreign banks and the putative benefits they bring to a domestic market. Finally, labor reform,

still a critical project to nurture more employment creation, especially in the historically anemic but recently nascent manufacturing sector, remains dubious, given the number of entrenched interests who are likely to resist such a major change.

Comment

¶9. (SBU) Opportunities for reform are significant, but with the Left gone, anti-reformists in Congress and the UPA have had their fig leaf taken away. There will still be some resistance to new reforms, although existing proposed reforms - legislation to increase FDI caps in insurance, give proportionate voting right to bank shareholders and enactment of PFRDA - should move forward, as will divestment, which the government needs for revenues. Allies' handling of ministries has been a mixed bag and thus the ability to implement these reforms will be affected by the assignment of portfolios. On the upside, Congress' position of strength in securing support above the minimum 272 seats means that it has more leverage over these ministers' performance; something it lacked with its razor thin majority in the last Lok Sabha.

¶10. The current large fiscal deficit (roughly 11 percent of GDP) constrains the government from expanding its social programs without rationalizing expenditures and finding new revenue sources. Prime Minister Manmohan Singh, himself riding an impressive mandate as only the second prime minister besides Jawaharlal Nehru to be re-elected after a full five year term, has already tied reforms to inclusive growth. It is likely that Singh will argue that the lack of fiscal space requires moving forward with investment liberalization and rationalization of expensive subsidies in order to free up more government spending and stimulate private sector investment in infrastructure. Fiscal constraints also may necessitate more revenues through 3G auction and public sector company divestment. The prospects for these reforms will become clearer over the next few weeks, as the government announces ministry appointments and possibly releases a 100-day plan that could prioritize reform goals. Post will continue to monitor and report.